S. HRG. 99-472

BANKING SECRECY ACT

HEARING

BEFORE THE

PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

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TUESDAY, OCTOBER 29, 1985

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BANKING SECRECY ACT

TUESDAY, OCTOBER 29, 1985

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, DC.

The subcommittee met at 9:30 a.m., in room SD-342, Dirksen Senate Office Building, under authority of Senate Resolution 85, section 13, dated February 20, 1985, Hon. William V. Roth, Jr. (chairman of the subcommittee) presiding.

Members of the subcommittee present: Senator William V. Roth, Jr., Republican, Delaware; and Senator Sam Nunn, Democrat, Georgia.

Members of the professional staff present: Daniel F. Rinzel, chief counsel; Eleanore J. Hill, chief counsel to the minority; Katherine Bidden, chief clerk; Majorie Kline, special assistant; and Paul Barbadoro, staff counsel.

[Senators present at the convening of the hearing: Senators Roth and Nunn.]

Chairman ROTH. The subcommittee will please be in order.

[The letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, DC.

Pursuant to Rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the Chairman, or any Member of the Subcommittee as designated by the Chairman, to conduct open and/or executive hearings without a quorum of two Members for the administration of oaths and taking testimony in connection with hearings on Federal Enforcement of the Bank Secrecy Act, to be held on October 29, 1985.

BILL ROTH,
Chairman.
SAM NUNN,
Ranking Minority Member.

OPENING STATEMENT OF CHAIRMAN ROTH

Chairman ROTH. Today's hearing on the Bank Secrecy Act continues the subcommittee's longstanding interest in offshore banking and money laundering. Although this series of hearings began several years ago, money laundering is still a matter of great concern because of its known link to organized crime and drug trafficking.

As recently as last week, a Federal grand jury indicted the Bank of New England, along with a bank officer and two head tellers, for

allegedly helping a convicted gambler illegally conceal 36 cash transactions totaling more than $800,000. The indictment accuses the Bank of New England of participating in a scheme to hide the cash transfers from the IRS and failure to report the transactions, thus ignoring the requirements laid out in the Bank Secrecy Act.

It has long been recognized that large cash transactions are often a signal that criminal enterprise is lurking nearby. Yet it seems criminals have met few obstacles as they guide the flow of illicit cash through legitimate banks and businesses. America's criminals, according to Government estimates, launder $40 billion annually. We have a number of cases, which we will include in the record, without objection.

[The information referred to follows:]

Recent Subcommittee investigations into Bank Secrecy Act violations by the Bank of Boston, financial institutions in Puerto Rico, and other U.S. banks indicated a shocking, widespread non-compliance with the Act.

The Subcommittee's investigation of the First National Bank of Boston was one of the earliest Federal investigations into how well domestic banks complied with the currency reporting requirements. The investigation quickly brought to light the unawareness and lack of attention that the reporting laws were given by both banks and the bank regulatory agencies.

For example, we heard evidence in the Bank of Boston hearing that examiners from the Office of the Comptroller of Currency were unaware of the currency transaction reporting regulations and, therefore, failed to cite the bank for this non-compliance.

Last February, the Bank of Boston pleaded guilty to failing to report $1.22 billion in international cash transfers, mostly with Swiss banks.

In our July 1985 hearing we heard evidence regarding an undercover investigation of financial institutions in Puerto Rico that led to the arrest of seventeen persons, most of whom were bank officials. This investigation also uncovered widespread non-compliance with the Bank Secrecy Act and allegations of cooperation among bank officials and drug traffickers to effect large currency transactions without filing the required Currency Transfer Reports. Again, there was evidence that bank examiners from the Federal Home Loan Bank Board failed to report incidents of non-compliance to the Department of Treasury.

Chairman ROTH. Just let me say that in these cases that were uncovered in Massachusetts and Puerto Rico, the question is whether they are isolated instances, or is there generally a lack of serious enforcement by the bank regulatory agencies?

As our earlier hearings have shown, the Bank Secrecy Act is a vital tool for law enforcement officials to use in fighting drug smuggling. Yet all the evidence we have seen so far indicates that the Federal agencies charged with enforcing the act are treating it more like a law against littering.

The requirements of the act were intended to disrupt the laundering and outflow of cash from drug trafficking and other criminal enterprises. It was recognized from the start that enforcement would be difficult. However, I am convinced that the first strike in the war against drug dealers must be aimed at domestic and international money laundering rings.

The Bank Secrecy Act enables us to crack down on criminals, but only if the requirements are being enforced and given considerable attention, both by bank officials and bank regulatory agencies.

Clearly, the lack of awareness and compliance uncovered in this subcommittee's investigation and in a series of disclosures by banks around the country, about their own failure to comply with the currency reporting laws, is unacceptable.

This grave concern of mine prompted me to invite GAO to testify today and report on their preliminary findings on just how good, or bad, the job the regulatory agencies are doing to ensure compliance with the Bank Secrecy Act.

[Senator Roth's prepared statement follows:]

PREPARED STATEMENT OF SENATOR ROTH

Today's hearing on the Bank Secrecy Act continues this Subcommittee's long standing interest in offshore banking and money laundering.

Although this series of hearings began several years ago, money laundering is still a matter of great concern because of its known link to organized crime and drug trafficking. As recently as last week, a federal grand jury indicted the Bank of New England, along with a bank officer and two head tellers, for allegedly helping a convicted gambler illegally conceal 36 cash transactions totaling more than $800,000.

The indictment accuses the Bank of New England of participating in a scheme to hide the cash transfers from the IRS and failure to report the transactions, thus ignoring the requirements laid out in the Bank Secrecy Act.

It has long been recognized that large cash transactions are often a signal that criminal enterprise is lurking nearby. Yet it seems criminals have met few obstacles as they guide the flow of illicit cash through legitimate banks and businesses. America's criminals, according to government estimates, launder $40 billion annually.

In fact, recent Subcommittee investigations into Bank Secrecy Act violations by the Bank of Boston, financial institutions in Puerto Rico, and other U.S. banks indicated a shocking, widespread non-compliance with the Act.

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The question is whether the cases uncovered in Massachusetts and Puerto Rico were isolated instances or if there is generally a lack of serious enforcement by the bank regulatory agencies.

As our earlier hearings have shown, the Bank Secrecy Act is a vital tool for law enforcement officials to use in fighting drug smuggling and other aspects of organized crime. Yet all the evidence we have seen so far indicates that the Federal agencies charged with enforcing the Act are treating it more like a law against littering.

The requirements of the Bank Secrecy Act were intended to disrupt the laundering and outflow of cash from drug traffickers and other criminal enterprises. But it was recognized from the start that enforcement would be difficult.

I am convinced that the first strike in the war against drug dealers must be aimed at domestic and international money laundering rings. The Bank Secrecy Act will enable us to attack this band of criminals, but only if the requirements are being enforced and given considerable attention by both bank officials and bank regulatory agencies.

Clearly, the lack of awareness and compliance uncovered in this Subcommittee's investigations and in a series of disclosures by banks around the country about their own failure to comply with the currency reporting laws is unacceptable.

This grave concern of mine prompted me to invite the General Accounting Office to testify today and report their preliminary findings on just how good—or bad—a

job the regulatory agencies are doing to insure compliance with the Bank Secrecy Act.

I am very interested to hear GAO's opinion on just how much emphasis these agencies have awarded the enforcement of the Bank Secrecy Act. Where are the enforcement gaps and what should the government be doing to plug them before we have another rash of Bank of Boston-type cases?

Chairman ROTH. Senator Nunn.

OPENING STATEMENT OF SENATOR NUNN

Senator NUNN. Thank you, Mr. Chairman.

I have a complete statement I will put in the record, but I am pleased to have the opportunity to be here today.

I congratulate you, Mr. Chairman, and the majority staff for achieving your probing work into this very important area. The money behind the narcotics in this country is staggering, and the Bank Secrecy Act and compliance with it is absolutely essential in that arena, as well as others.

So, we are interested in hearing from the GAO this morning, and we appreciate our witnesses being here.

[Senator Nunn's prepared statement follows:]

PREPARED STATEMENT OF SENATOR NUNN

Mr. Chairman, in March and July of this year, you convened hearings on the problem of money laundering. From all published accounts, money laundering apparently continues to be an effective means to conceal and even legitimize profits gained through narcotics trafficking, illegal gambling, embezzlement or any of a number of other illicit activities. In focusing on the problem again with these hearings, I congratulate you and the Majority Staff for your fine work in bringing this important issue to the attention of Congress.

Through the earlier hearings we learned of the astronomical sums of money that are involved in narcotics trafficking as well as the surreptitious methods that criminals often use to divert their profits through an obscure underground economy. In March, 1985, the Subcommittee focused on the failure of some of our financial institutions to adequately comply with the reporting requirements of the Bank Secrecy Act.

Mr. Chairman, I was particularly concerned by cases where financial institutions and their employees have apparently violated those provisions. Full compliance with the Bank Secrecy Act is critical to our efforts to prevent the laundering of illegal profits. The reporting requirements of the Bank Secrecy Act were designed to help law enforcement identify and pursue illegal money laundering schemes. This morning, I look forward to hearing our witness, William J. Anderson, Director of the General Government Division of the General Accounting Office, regarding GAO's findings and recommendations on the important issue of enforcement of the Federal Bank Secrecy Act and its accompanying regulations.

I recognize that there have been numerous voluntary disclosures by financial institutions in the last few months of past failures to comply with federal reporting requirements. Failures to comply may or may not have been inadvertent on the part of the institutions. Some may have been prompted by government's failure to adequately educate those institutions or to effectively monitor compliance in the private sector. I am hopeful that GAO's testimony this morning will shed some light on ways to improve government efforts to insure meaningful and widespread compliance with the Act.

As you know Mr. Chairman, organized criminal activity thrives because it is enormously profitable. Controlling organized crime requires a strong and combined effort by Congress, the Executive Branch and the private section. We cannot oblige criminals by creating avenues where there is little resistance. We must do our best to halt the flow of illegal and untaxed profits to the coffers of organized crime.

Again, I want to commend you Mr. Chairman and your very able staff for staying on top of this issue.

Senator ROTH. Thank you, Senator Nunn.

Mr. Anderson, will you and Mr. Simmons and Mr. Moura, who are going to testify, please stand and raise your right hand?

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. ANDERSON. I do.

Mr. MOURA. I do.

Mr. SIMMONS. I do.

Senator ROTH. Please be seated.

Mr. Anderson, would you please introduce yourself and the other gentlemen with you and then proceed.

TESTIMONY OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY CRAIG SIMMONS, ASSOCIATED DIRECTOR FOR FINANCIAL INSTITUTIONS AND MARKETS, RICHARD MOURA, ASSIGNMENT MANAGER, AND JOHN VIALET, GAO EVALUATION

Mr. ANDERSON. Mr. Chairman. Good morning, good morning, Senator Nunn.

My name is Bill Anderson, I am Director of the General Government Division at GAO. One of the activities I am responsible for is GAO's work in an area we call financial institutions and markets.

Craig Simmons, to my right, is the GAO Associate Director responsible for that work.

As you're aware, sir, Comptroller General Bowsher decided that GAO could be doing more to assist the Congress as it tries to understand what's happening out there in the deregulation of the financial institutions and markets and has established an initiative and established a number of people under Graig's leadership.

Craig worked with Comptroller General Staats and Comptroller General Bowsher in the New York City rescue situation and the Chrysler loan board support. So, he was one of our key people and designated to head this new area.

Dick Moura, to my left, is in GAO's terminology, the assignment manager in charge of this particular job that we did in response to your request of March 19.

With your permission, sir, I would like to have my full statement put in the record. I have some notes here. I would like to briefly summarize what the main points are.

Senator ROTH. Please proceed.

Mr. ANDERSON. Thank you, sir.

In your March 19 request, you asked us to do two things: First, you asked the question, basically, how effectively are the regulatory agencies doing their jobs with respect to Bank Secrecy Act compliance? You also asked us to look at the effectiveness of the law enforcement agencies in using Bank Secrecy Act data in prosecuting major criminals.

My testimony today concerns part 1; namely, how well are regulatory agencies doing their job of Bank Secrecy Act oversight.

First, to tell you a little bit about our scope of review, I think it is important to know what we did do. We randomly and scientifically sampled 1,254 examinations conducted in six geographical re-

gions of the country. The regions were chosen because it was thought that they were likely candidates for Bank Secrecy Act violations: Florida, New York, New Jersey, California, areas like that.

With respect to those six parts of the country, we can say that what we found is statistically representative of the situation you would expect to find with respect to all the examination reports and the examination activity in those areas.

Broken down, we looked at 187 examinations conducted by Federal Reserve personnel, 261 by Comptroller's personnel, 254 by FDIC, 252 by the Bank Board, 300 by the National Credit Union Administration. In those same six geographical areas, we also looked at all 183 SEC oversight examinations, so we covered them 100 percent. There were too few to really sample.

And then finally, with respect to the IRS, what we did was we chose those four parts of the country where IRS was doing the most of these types of examinations. In fact, they accounted for the bulk of the staff years they were putting into the BSA reviews, and we ended up looking at a sample of 48 of 420 examinations.

The areas were Manhattan, Brooklyn, Illinois, and Dallas. The results of our findings—well, we found that the three principal regulatory agencies, bank regulatory agencies, Federal Reserve System, the Comptroller of the Currency, and FDIC, all required use of a set of model procedures that had been developed by the Federal Financial Institutions Examination Council, a group consisting of representatives from all the bank regulatory agencies, kind of charged with identifying model practices for their common use; training and provide centralized training and that sort of thing.

We looked at the six regions, six geographical areas at each one of those three agencies, a total of 18 offices.

First major finding. At only 4 of the 18 offices did we find an adequate job of performing and documenting the various review steps incorporated in the FFIEC guidelines, Federal Financial Institution Guidelines, in only 4 of the 18 offices. All four, by the way, were Federal Reserve Offices. The other two agencies, OCC and FDIC, we did not find any office where we considered a truly adequate job was being done of performing and documenting.

More fundamental, the model procedures require a written summary at the conclusion of module 1 as to what the findings were and why a decision was made to proceed or not to proceed to module 2. Essentially, what the Institution Council Guidelines provide is that there are two separate modules: module 1, I'll call, exploratory, gaining a working knowledge of the type of procedures that the institution has in place; getting some preliminary information on currency flows within the institution; understanding what the internal audit procedures are; information like that. And on the basis of what, making a determination that, yes, they seem to have their house in order; we will not proceed to module 2.

It seemed to me to be a very crucial step in deciding how deeply to go into the examination. Well, at the time of the 702 examinations, we looked at those three regulatory agencies, in those six areas, we found 59 or 8 percent of the examinations where module 1 was concluded with an analysis of what we found and why we're

not going to do module 2. So, we thought that that was a rather significant shortcoming.

Let me turn now to another regulatory agency, the Federal Home Loan Bank Board.

Our review results were consistent with the testimony provided you by William Shilling, Director of the Board's Office of Examination and Supervision just a couple of months ago, in which he noted that a severe shortage of examiners and an emphasis on safety and soundness resulted in a decrease in emphasis on Bank Secrecy Act work.

In fact, we found that many of the necessary steps in examining BSA compliance were not conducted by the Bank Board examiners. Similarly, the National Credit Union Administration, since October 1972, has made any work at all in the Bank Secrecy Act compliance area optional on the part of the examiner. There was no compulsion to do anything at all. And, in fact, we looked at 300 examinations conducted by NCUA examiners and found three instances where anything at all was done in the area of Bank Secrecy Act compliance.

At the Securities and Exchange Commission, we found that the agency was using a six-point checklist it had developed. This agency really was not a part of the development of the Federal Financial Institution's Examination Council checklist, and developed its own procedures. In most instances, we found that the checklists were filled out, but there was no supporting documentation describing what was done in carrying out the steps performed in connection with the checklist.

A Treasury Department official, who is responsible for bank secrecy oversight told us that he believes that SEC's checklist lacks a sufficient detail and thus could result in inconsistent examinations. We agree. More detailed procedures are needed.

Now. I'll turn to IRS, the last organization we looked at. Technically, IRS was doing a good job in its examinations. We found generally well-documented adherence to its detailed review procedures. IRS' problem is trying to identify the universe of firms it is responsible for examining.

Let me quote from some of the types of firms that were identified in Public Law 91-508: a licensed transmitter of funds, a travel agency, a loan or finance company, a pawnbroker, and most importantly, "any other type of business or institution performing similar, related or substitute functions specified by the Secretary."

IRS does not have what it would consider a definitive list of the types of firms it must examine. Further, it must resort to the telephone book yellow pages to identify specific firms to examine. That's the process that it follows in identifying firms to get after.

What needs to be done and what is being done? Well, let me return first to the three principal regulatory agencies I started off with, the Fed, FDIC, and the Comptroller of the Currency.

We think that there's a need for them to revisit the adequacy of the standard procedures I spoke about, the Federal Financial Institution Examination Council procedures. Module 1 does not require any detailed testing of transactions. It's all more or less of a theoretical exercise based on controls being in place and that sort of thing, other than looking at the currency flows.

Price Waterhouse was hired by the Bank Board, you will remember from your testimony, to take a look at what they were doing with respect to Bank Secrecy Act compliance. They had one comment in the report to the Bank Board I thought was rather significant: They said that, hey, without transaction testing, you really can't feel too secure about your ability to assure compliance with the Bank Secrecy Act, and as I said before, module 1, the major part that's being performed out there in connection with these uniform procedures, does not require transaction testing.

There's a need for those regulatory agencies to improve their oversight of what's being done by their field offices. I mentioned a general lack of documentation of what was being done. Examiners would tell us, oh, yes, we were doing all those good things in connection with the act, but there was no evidence in the work papers that they actually had done that, and GAO, in connection with the standards that it issues on auditing generally has taken a strong position that, let me quote from our so-called yellow book, sir, "working papers were the link between field work and the auditor's report. They serve as a record of the results of the examination and the bases of the auditor's opinions." Well, we don't have that type of trail with connection to virtually all of the examinations that are being conducted with those exceptions, especially in the Fed that I spoke of earlier.

There's a need to help the examiners do their jobs better, and I speak here to support advanced support being provided by the Treasury, perhaps by the institution itself. That examiner should go in there knowing whether in fact the institution had any suspicious currency flows as evidenced by analyses that could be conducted.

He or she would know what the experience has been with respect to filing transaction reports, 4789's and 4790's. Do they seem proportionate in terms of the size of the institution and the currency that it is reporting?

They ought to know whether, in fact, there are any suspicions at all on the part of the law enforcement community about that particular institution. They don't have that type of thing, that type of information.

There are some activities within the institutions that aren't even being covered, even by the module 2 of those procedures I spoke about earlier, which require, I'm sure you recollect, testing of teller transactions. Well, when you take the Bank of Boston, for example, First Bank of Boston, that wouldn't have got you into the currency control function, and the foreign exchange function, where, in fact, in that particular case, a part of the violations of the act occurred.

Now, you're aware that Treasury is leading an effort right now to review the procedures that are used by all the organizations that have responsibility here. Things are not proceeding, I think, as well as Treasury would like them in terms of the responsiveness they are getting from the comments of the firms, of the organizations, but at least hopefully, that will provide an opportunity to address some of the problems that I spoke about.

Let me turn now to the Bank Board. The long way to go is the first words that came to my mind as I thought over what we had found.

Mr. Shilling, in his testimony to you, described a number of steps that they were considering and said that they would also be swayed by what Price Waterhouse told them about what was needed to improve their oversight, their compliance with the law.

At SEC, I spoke earlier of the need for detailed guidance to back up that checklist that they have and to provide for documenting the work performed in connection with the checklist. And then with respect to IRS, this uncertainty that I kind of feel about the adequacy of the resources, the coverage they're providing. Right now, I'm not aware of any count at all of what the universe is. We know that the universe is of the organizations that are covered by the regulatory agencies, the 13,000 Federal credit unions, the 15,000 banks, et cetera. Well, we have no idea at all how many of these institutions that IRS should be looking at, and no idea at all as to what part of that universe they're catching, the adequacy of, they say, 4½ staff years that they're putting into this sort of thing, how adequate that is, what the vulnerabilities are with respect to all those types of organizations. The bottom line summary is that I feel we're putting a lot of effort out there, but I wonder how well focused it is.

The effort that we're putting in does not appear to be well managed by the heads of the various regulatory agencies that are responsible for it. You almost sense that there's a need to rethink what institutions we look at in depth and what an indepth look should consist of from the standpoint of the procedures that apply.

Maybe there ought to be tiered procedures depending on the assessment of the vulnerabilities at particular institutions.

In any event, let me stop here, Mr. Chairman, and Mr. Simmons and Mr. Moura and myself will try to answer any questions you or Senator Nunn would have.

Chairman ROTH. To sum it up, if I understand you correctly, you're saying the job is inadequate.

Mr. ANDERSON. That is correct, sir.

Chairman ROTH. Are there any exceptions to that general description? You have got, what, seven different agencies involved?

Mr. ANDERSON. That is correct, sir.

Chairman ROTH. Are any of them doing an adequate job in your judgment?

Mr. ANDERSON. I would say that the Federal Reserve, in four of the six offices that we looked at, we thought was doing a good job. They were the ones. Of the bank and S&L regulatory agencies, the Fed was the one that we thought was doing the best job in four of the six offices.

In the other two offices, they weren't doing quite as well. They, at those four offices, as a matter of course, moved right into those module 2 procedures, the detailed transaction testing.

Beyond that, I mentioned that IRS, for what it was doing, appeared to be doing well. The SEC used its checklist and you couldn't really tell how effective their examinations were.

So overall, the Fed, at some locations, was doing a good job. IRS and SEC to a lesser extent.

Chairman ROTH. The other four agencies you would say are inadequate. To what extent do you think the problem is that they still

don't deem this important or at least as important as the financial integrity of the bank or financial institution?

Is this sort of rated No. 2 as far as their investigations are concerned, so it is not getting the attention that other matters are?

Mr. ANDERSON. The sense that I came away with after reviewing the work that our people had performed was that that is the problem, that they are, these examinations do encompass an awful lot of items.

In fact, they even look at a lot of other pieces of legislation from a compliance standpoint, truth in lending, CRA and others. The point was made, I thought by one of your witnesses earlier this year, that that 250-page report on First Bank of Boston maybe had a paragraph or so on the Bank Secrecy Act. I think that the examiners have not been educated to the special importance that the framers of the Bank Secrecy Act attached to their part in trying to make this whole system of documenting currency flows work as part of our war on organized crime and drugs. I sense that that is an important part of it.

Chairman ROTH. The claim is made that there are not enough people, not enough examiners; is that correct?

Mr. ANDERSON. The only place where I—where I saw clear evidence, evidence, assertions on the part of the organization was on the part of the Bank Board, where they pleaded, where Mr. Shilling pleaded here that they couldn't get the job done because of cuts that had been made in their resources.

With respect to the other organizations, obviously, I guess nobody in government ever has as much as they think they could use, but I would be reluctant to say that they couldn't, perhaps by choosing the procedures wisely, choosing the organizations that they need to go in depth in, get by and do the job that needs to be done with the resources they have.

I would be reluctant to say that—except IRS, where I have that uncertainty. We don't know what the size of the job is, and we really have no basis to gauge the adequacy of the staff.

Chairman ROTH. Is part of the problem that they tried to look at too many institutions and those that they do look at they do not look at carefully enough? For example, IRS cannot examine, in detail, every return filed by the American people. They have to be selective. They target returns. Do the bank regulatory agencies need to do more on that? I am always concerned about this problem of resources, because you are never going to have enough resources to please the regulators, in my opinion, and yet the job has to be done.

Can more be done in the way they target their investigations?

Mr. ANDERSON. I would say I see two things as being possible: first, on the one hand, I believe that at all the institutions they do go to, as a matter of course, annually, it seems like an ideal opportunity, since you're going to have an onboard presence, to do something, but the thing is, to do something effective.

And what I don't know is, could you devise a set of revised procedures that, in that short period of time that you're in there on an examination, you could develop sufficient evidence to find whether, in fact, there has been good compliance. On the other hand, getting back to your point, yes, I believe that there's room here.

You know, the thing that comes to my mind is that so-called discriminate function analysis that the IRS used to single out our tax returns, a high probability of a hit of some kind. I see that you could devise some criteria like that and that for a subset of those organizations that are examined, you would go in, in depth with a set of procedures that would really answer yes or no, violations are or are not occurring.

Mr. SIMMONS. If those random sample examinations were sufficiently intense and did involve exhaustive tests of transactions and violations had sufficient penalties associated with them, it's entirely possible that doing perhaps 400 financial institutions a year and finding violations in many of those cases could provide a significant deterrent effect for other financial institutions, particularly if financial institutions didn't know when they were going to get the intensive examination.

That might be an alternative to attempting to do a bank secrecy compliance examination on all 15,000 banks, all 11,000, 12,000, 13,000 credit unions, the thousands and thousands of businesses that the IRS has to deal with. That might be a better way to use the resources.

Mr. ANDERSON. Mr. Simmons triggered a thought in my mind, sir, that took me back to the hearing record that you created a few months ago, and there was something in there I thought was really relevant.

It was on, I think it was William Brown. I can't remember his position at First Bank of Boston, but he spelled out all the things that the First Bank of Boston was going to do in reaction to these disclosures, and it brings home the need to educate the institutions themselves.

In other words, right now, we are talking about checkers going in and finding wrongdoing. Has there been enough emphasis on trying to get out to the banks and educating them on the importance of doing these things?

I think your Shawmut witnesses, as well, Shawmut also described the things that they were starting to do, as well. I don't know. That is an approach that we haven't heard too much about that we need to explore.

Senator NUNN. If I can interject, I think that is particularly important. I think particularly the small banks, I don't have any problem with the big banks, although there is nothing wrong with counseling them, too. But the smaller banks simply do not have the personnel. Somebody that is going to have to keep up with all these things is keeping up with 10 other things.

If we look at it from an isolated point of view and say, why didn't you comply with this, and you bat out on one point, the question is very appropriate. When you look at 1 person or 2 people having to keep up with not only this, but 100 other things in a small banking institution, I think it is impossible, and I would hope the agencies would take some kind of approach, this targeting approach just mentioned is a very good deterrent, and it would certainly allow them to do a better job in institutions they do go in and check rather than trying to cover the whole waterfront, and second, in terms of the size of the banks, set up some type of liaison counseling service that would go around, and before having, not necessari-

ly before, but in addition to having the deterrent effect here, it would counsel as to what they are supposed to be doing and why.

I think it is very important that they be told why. It is important for the law. So I would hope, Mr. Chairman, that we consider some kind of possible recommendation to the agencies along this line. I think those are good suggestions.

Chairman ROTH. Thank you, Senator Nunn. In our report, I think we ought to cover these points. Let me ask you this: A number of financial institutions have been found guilty of violating the Bank Secrecy Act. Have these been primarily uncovered by the regulatory agencies or not?

Mr. ANDERSON. No, sir, they have not. Most of the ones that came forward came after the Bank of Boston voluntarily came forward. Shawmut was the first, and New York institutions—I understand a total of 40 or 50, I think, according to your own hearing record, came forward. As far as I know, Crocker is probably the only instance of a large institution with significant violations that was detected as a result of examination.

[At this point, Senator Nunn left the hearing room.]

Mr. ANDERSON. Well, I think that they're going to have to review the procedures that they use at the institutions they go into, and, in fact, assure themselves that the things they're doing would detect violations of the bank, the things that they're looking for to find out whether, in fact, there has been compliance.

I'm not so sure that they don't. In fact, I think that they also ought to be concerned with the targeting that we spoke about earlier, at least be more selective in those institutions where you're going to look in depth, but have a basis for identifying.

And also, I would say that we concluded that there was a need for the management of these various regulatory agencies to keep better informed and oversee more tightly what their people are doing in the field to ensure compliance with basic examination and auditing procedures.

Chairman ROTH. In some of the hearings we held earlier, there appeared to be a deplorable lack of guidance from the home office of the bank regulatory agencies to the field units. Is this situation improving?

Do you believe that the various agencies are beginning to first give training then subsequently review and determine what level of enforcement is being followed in the field offices?

Mr. ANDERSON. I'm going to let Mr. Moura comment on that a bit. I know that they were all sensitized about the importance of this type of work as a result of the hearings that this committee held, and I guess my question to the staff was, well, has this been reflected in doing anything differently or better in 1985, and I'll let Dick tell you what he found.

Mr. MOURA. Mr. Chairman, ever since the Bank of Boston revelation, it seems that there has been a higher emphasis placed on Bank Secrecy Act compliance by both the regulatory agencies' headquarters and field personnel. We have observed that policy directives were sent from headquarters to the field activities, reinstituting, for example in the case of the Federal Home Loan Bank Board, the use of bank secrecy examination procedures that they had suspended a few years ago.

We have also seen increased bank secrecy training. In general, there has been increased emphasis by most of the regulators, which is similar to their reactions of 4 years ago, after the last set of hearings that emphasized this problem. We have seen an increased emphasis again at this point in time, but it occurred after the Bank of Boston revelation.

Chairman ROTH. In your opening statement, you made some reference to the responsibility of the Treasury Department, and the apparent inability to reach a consensus as to how to proceed in this area by the agencies involved.

Is that correct?

Mr. ANDERSON. That is correct, sir. I mentioned also that there has been progress in that regard and that right now, Treasury is working on it.

Chairman ROTH. The problem is—let me be candid—progress is nice, but when do you think they will be able to complete this work?

Mr. ANDERSON. I would be a little concerned about that, sir, because I know that—I think that Treasury was calling for input from all of these regulatory agencies by July 1 of this year, and as of, I think, yesterday, we had checked, they had heard from two of the seven. So things are not progressing.

Chairman ROTH. Has there been any followup on the part of Treasury to get results?

Mr. SIMMONS. I understand that they have or intend to send reminder letters to the agencies.

Mr. MOURA. Yes, sir.

Mr. SIMMONS. Reminding them of the deadline and the fact that it has passed.

Chairman ROTH. Do they have any target date to complete the work, or are we going to have a meeting next year and they will say, "Well, we are still proceeding"?

Mr. SIMMONS. I'm not aware of the target date, do you?

Mr. MOURA. No. We are not aware of the target date.

Chairman ROTH. Would it help to have a target date?

Mr. MOURA. Yes.

Chairman ROTH. How long should it take to complete this kind of a job? Can you give us a ballpark estimate?

Mr. ANDERSON. I think it should take no more than 3 months, max. You have very knowledgeable people from these agencies. Maybe it should be conducted through the mails; that might be another way to do it; maybe get all key representatives from the organizations and sit around and thrash out on the basis of the vast experience they have had in doing this sort of thing and decide what needs to be done better and differently.

Chairman ROTH. I think we ought to ask the Treasury to advise us when they expect to complete this aspect of the problem; I am not satisfied. I don't see the kind of progress being made that I think should be made.

Going back to the question of documentation, that is a requirement that always bothers me. Is that going to require considerably more man-hours, and for what purpose? You document what the examiner does. Who examines the documentation for what purpose?

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Mr. ANDERSON. I would say that, No. 1, that it's important that the first line performer, what was his name, Rollo, I think, in your First Boston case, it was a junior examiner that was doing it. I would say that Mr. John Conners, his supervisor, had no basis to really understand what Mr. Rollo had done and verified that it had been done.

This could be expensive if you indiscriminately went in depth in all the institutions that you examined. But it's a price that people in the auditing profession, which I think is very comparable to the type of activity we're talking about here, have found to be cost effective; that you have to have that type of assurance that the person, the first line person doing it is doing all the things that they should do and doing it well.

Yes, it would be costly; it's costly to document. But again, I think that the gain to be had in assurance that the audit or the examination was properly conducted is worth it.

But I'd say that if we went back earlier to more selective targeting of the institutions we do have, maybe some of the efforts put out might be no more than it is at present where we're doing a little at an awful lot of places.

Chairman ROTH. I agree with that. I think I would rather target and do a thorough job than just skim the surface in many places.

Mr. ANDERSON. Yes, sir.

Chairman ROTH. I think that is a problem.

Mr. RINZEL. In our investigation in the Boston and Puerto Rico situations, we found evidence that many of the examiners were not familiar with the Bank Secrecy Act; did not understand it. Is this a widespread problem as far as your study is concerned? Do you have any information about that? If it is a widespread problem, what can we do?

Mr. ANDERSON. We looked at the type of training that the people were getting and found it was sort of a mixed bag—but it seemed that all of the examiners would have been exposed to some information about what the Bank Secrecy Act is and what its requirements are.

The examiners themselves would tell you that, and we surveyed a number of them. "Oh, yes," they would say, "We would know. We know. We know what the requirements are that we have for doing what we need to do in connection with Bank Secrecy Act examinations."

On the other hand, it was established very well here that their knowledge of the details, I would have to be concerned about, because we found out that those—that the 1982 changes apparently regarding especially international transactions and the exempt list requirements, apparently escaped the attention of a number of examiners who weren't alert to that, you know, alert to those changes in their own examinations. I would say our evidence, what we did, though, will not produce, I'm afraid, any useful new evidence on that subject.

Mr. RINZEL. Can you tell us the status of the portion of the study that GAO is conducting on the law enforcement side? What you are planning to do in that area?

Mr. ANDERSON. We are still working on that part on it. In fact, one of the key people on that job, Mr. John Vialet, is sitting in

here. The one thing I haven't cleared with John is when he would expect to be in a position to give some input to this committee, either in the form of written or oral testimony. Let me ask him that right now.

Mr. VIALET. We will be ready to testify in the spring sometime.

Mr. ANDERSON. In the spring he says, sir. There is still a lot of bases to touch in connection with that one, trying to come away with some kind of feel that is actually being made out there.

Mr. VIALET. We would anticipate completing our field work sometime in January or February. I think sometime shortly after that, we would be in a position to testify.

Mr. RINZEL. I understand, for example, in the aftermath of the Boston situation, there has been a substantial increase in filings of CTR's and as a result, there has been a tremendous increase in the backlog in getting the information from the CTR's into the computer system.

Do you have any information about that?

Mr. ANDERSON. Yes; we do. We had a tally that showed as of a recent date, it might even have been October 1, there were 522,000 in the backlog for entry into the system, 522,000.

Mr. RINZEL. Obviously, law enforcement agencies can't get access to this information until it gets put in the computer system; is that correct?

Mr. ANDERSON. Absolutely correct, sir; what I can't tell you so far is if, in fact, this same higher level of reporting is what we can anticipate down the road. We may have to revisit our present computer capacity. Perhaps it isn't even sufficient to overcome the backlog.

Maybe we are going to have to devote more resources to it. And that's obviously a question that's critical to Bank Secrecy Act compliance.

Mr. RINZEL. I have no further questions, Mr. Chairman.

Chairman ROTH. Thank you, gentlemen. We appreciate your being here. We are eager to have the final report as rapidly as possible and look forward to working with you on that.

Mr. ANDERSON. Thank you very much, Mr. Chairman, my pleasure.

[Mr. Anderson's prepared statement follows:]

United States General Accounting Office

Washington, D.C. 20548

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STATEMENT OF

WILLIAM J. ANDERSON, DIRECTOR

GENERAL GOVERNMENT DIVISION

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

ON THE

FEDERAL REGULATORY AGENCIES' EFFORTS

TO ASSURE BANK SECRECY ACT COMPLIANCE

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to provide our preliminary results from the review you requested on March 19, 1985, on how various regulatory agencies assure compliance with the Currency and Foreign Transactions Reporting Act (also called the Bank Secrecy Act). This act and implementing regulations require various institutions--banks, credit unions, savings and loans, securities brokers, and others--to report currency transactions greater than $10,000. The act is a key tool in investigating and prosecuting drug traffickers and other criminals who depend on cash and its free movement.

The Department of the Treasury is responsibile for enforcing the Bank Secrecy Act. Treasury has delegated authority for assuring compliance by financial institutions to five depository institutions' regulatory agencies, the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS). Although the regulatory agencies undertake examinations of their constituent financial institutions to assure compliance with the act, our preliminary results show that these agencies, as a group,

--place greater emphasis on mission-related objectives, and lesser emphasis on Bank Secrecy Act compliance when allocating examination resources, because they believe these resources are limited;

--do not have detailed Bank Secrecy examination procedures and apply those they do have inconsistently;

--do not sufficiently document the examination work performed, which makes it difficult to accurately assess how well examiners are performing compliance examinations; and

--tend, in some instances, to use examiners with lesser levels of experience and training to assess compliance with the act.

In addition, we found that the examination procedures used as a model by the five depository institutions' regulatory agencies could be strengthened. Furthermore, Treasury and all the agencies could better communicate and coordinate their Bank Secrecy-related activities with one another and thereby enhance the overall compliance effort.

We also found that the IRS, which has responsibility for examining such institutions as pawnbrokers, is experiencing difficulties in identifying other institutions they should review for compliance with the act. According to IRS officials, this is because the implementing regulations do not clearly define such institutions.

These results are similar to those in a report we issued in 1981.[1] At that time, we made some recommendations which were not accepted or implemented by these same agencies, but which we believe are still relevant.

Having said this, I should also note that Treasury and the regulatory agencies are proposing and implementing initiatives

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[1]Bank Secrecy Act Reporting Requirements Have Not Yet Met Expectations, Suggesting Need For Amendment. (GAO/GGD-81-80).

to improve their compliance with the act. I will describe these later in my statement. Since the initiatives are in the proposal stage or just beginning to be implemented, we did not fully evaluate them.

SCOPE OF REVIEW

As you requested, we reviewed the activities of the following seven agencies:

--the Federal Reserve System (FRS),

--the Office of the Comptroller of the Currency (OCC),

--the Federal Deposit Insurance Corporation (FDIC),

--the Federal Home Loan Bank Board (Bank Board),

--the National Credit Union Administration (NCUA),

--the Internal Revenue Service (IRS), and

--the Securities and Exchange Commission (SEC).

The first five agencies are members of the Federal Financial Institutions Examination Council (Council). This Council was created in 1979 to coordinate policies of the depository institution regulatory agencies.

We also discussed compliance procedures with officials of the National Association of Securities Dealers (NASD), the New York and American Stock Exchanges, and the Treasury Department.

We reviewed more than 1,400 examination files from a statistically valid sample of examinations conducted in calendar year 1984 by the seven regulatory agencies and discussed examination procedures with top-level officials and field examiners. We concentrated on 1984 because late in that year and in early 1985 revelations of currency transaction reporting

violations at several banks led to this subcommittee's March 11 hearings and to increased attention to the reporting problem.

Our study included institutions from eight states having a high potential for money laundering.

In evaluating the examination files, we looked for an indication such as use of a checklist that Bank Secrecy Act procedures were applied. We also looked for supporting workpapers describing the nature and extent of the work performed by the examiners. The presence or absence of supporting workpapers in any given examination does not conclusively prove that procedures were or were not applied. However, based on our discussions with some examiners, we adopted the premise that variations in the quality of evidence would indicate variations in the application of procedures.

Our staff has gathered a great deal of detailed information that we believe will be useful to the Subcommittee. Recognizing practical time limitations, my remarks today will highlight our preliminary findings, conclusions, and recommendations. These, however, are still being developed and will be included in our written report.

FEDERAL FINANCIAL INSTITUTIONS' REGULATORS HAVE GIVEN A LOW PRIORITY TO BANK SECRECY ACT COMPLIANCE EXAMINATIONS

Because regulators see their primary roles as being preservers of the safety, soundness, and integrity of the financial system, and because they see examination resources as being relatively limited, they have given Bank Secrecy

examinations a relatively low priority. Federal regulators of depository institutions--the FRS, FDIC, OCC, Bank Board and NCUA--give greatest attention to monitoring for safety and soundness, especially given the increasing list of problem banks and savings institutions. The SEC's stated mission is to maintain the integrity of the financial marketplace and to protect the financial interests of investors in these markets. IRS' stated primary objective is enforcing compliance with the tax laws.

Along with these primary objectives, the regulatory agencies perform several types of compliance examinations at their constituent institutions, with Bank Secrecy Act compliance being but one of several.

During our review we found that:

--Only FRS's examiners routinely performed transaction testing, which, in our opinion, is key to assuring compliance.

--NCUA's examiners performed few Bank Secrecy Act examinations in 1984.

--Bank Board policies make performance of Bank Secrecy Act examinations optional at the examiner's discretion.

--OCC and FDIC examiners have not documented their examinations sufficiently, based on recognized standards, for their own management or any external evaluator to assess their performance.

--SEC uses a checklist, but has no detailed Bank Secrecy Act examination procedures.

Overall, the Federal Reserve Banks we evaluated generally performed the most comprehensive Bank Secrecy examinations in their member institutions.

EXAMINATION PROCEDURES APPLIED INCONSISTENTLY OR NOT APPLIED AT ALL AT DEPOSITORY INSTITUTIONS

In 1981, the Council developed model procedures for depository institutions' regulators to use in Bank Secrecy Act examinations. Unfortunately, most of the agencies apply the procedures inconsistently. Moreover, the NCUA does not use the Council's detailed procedures, and the Bank Board leaves the use of Bank Secrecy Act procedures up to the discretion of examiners.

The Council's procedures, which were developed in cooperation with the Treasury Department, consist of two modules:

--Module I is limited in scope and is designed to ascertain if a financial institution has adequate operating standards and internal audit procedures.

--Module II contains expanded, more detailed procedures that, for example, test specific teller transactions involving the deposit and withdrawal of cash.

Module II is used only if the examiner deems it necessary. However, if Module II is not used, the examiner is required to prepare a Module I summary explaining why.

During 1984, the period we reviewed, FRS, OCC, and FDIC officials required their examiners to use the Council's model procedures. Although some FRS offices consistently performed the basic Module I procedures, at the other FRS, FDIC, and OCC offices we visited, we found little evidence that these procedures were performed consistently or comprehensively. Moreover, in those instances where Modules I or II were used, we found that they were used inconsistently. For example, certain field offices of some bank regulators did not check currency shipments for the required 6-month period preceding the examination, while other offices of the same regulators did. Further, at some locations, we found that examiners reviewed banks' standard operating procedures, while at other locations we found no such evidence. As another example, we found that only 59 of the 702 examination reports we reviewed at these 3 agencies contained the required, written summaries explaining why Module II procedures were or were not performed.

The Bank Board adopted the Council's model procedures, but suspended the mandatory use of all examination procedures in 1982. Although the Bank Board advised its offices to consider the Council's procedures as the model to use if they performed Bank Secrecy Act examinations, it permitted its examiners to use them at their discretion. At the Bank Board, we found little evidence that examiners performed Module I procedures, and no evidence they performed Module II procedures.

Table I summarizes our findings on how consistently Module I procedures were applied as shown by the amount of evidence

contained in examination files.

Table I
Module I Procedures:
Extent of Performance
and Supporting Evidence
(percentage)

(a) Agency	(b) Performed with full/some support	(c) Performed with no support	(d) No evidence of performance	(e) Not performed	(f) Not applicable/ Other	(g) Total
FRS	14	30	22	1	33	100
OCC	11	27	39	2	21	100
FDIC	11	11	62	0	16	100
FHLBB	5	4	66	2	23	100

In looking at the figures in columns c and d, we found either no documentation supporting performance of the procedures or no evidence they were performed in 52 percent of the FRS' procedural worksteps, 66 percent of OCC's, 73 percent of FDIC's, and 70 percent of the Bank Board's. The absence of supporting documentation demonstrates two problems: first, contrary to the Council's intent, the procedures were not used consistently; second, the workpapers did not meet recognized documentation standards, and therefore, do not demonstrate the extent to which procedures were used, a point I will elaborate on later.

Also, note the absence of the NCUA from the table. In February 1981, the agency adopted procedures which were similar in concept to the Council's. However, in October 1982, in order to increase its safety and soundness examinations of credit

unions, NCUA revised its Bank Secrecy examination procedures and adopted a scaled-down version that permitted examiners to vary the scope of examinations according to the financial condition of the credit union being examined. Under the scaled-down procedures, NCUA examiners were not required to specifically address Bank Secrecy matters. Our review of a significant sample of NCUA's 1984 credit union examinations disclosed that in only 3 of the 300 examinations reviewed did we find instances where a basic procedural workstep was performed. According to NCUA officials, many credit unions do not handle large cash transactions. Therefore, application of these procedures may only apply at those credit unions where large cash transactions are likely.

We also found inconsistent application of Module II procedures among the agencies. Although the Council's procedures do not require the performance of expanded worksteps on all Bank Secrecy examinations, at some offices, there was no evidence that the Module II requirement to test-check teller transactions for a minimum of 5 days was being performed. This teller transaction testing is a procedural requirement to verify that all transactions greater than $10,000 have been reported. In other locations, Module II tests of teller transactions were performed in a relatively high percentage of examinations. The following table summarizes, out of the total number of examinations we reviewed, how often we found evidence that the examiners tested 5 days of teller transactions:

Table II
Number And Percent Of Total Examinations In Which
5 Days Of Teller Transactions
Were Reviewed

	OCC		FDIC		FRS		FHLBB		NCUA	
Locations	#	%	#	%	#	%	#	%	#	%
MA/RI	0	0	0	0	0	0	0	0	0	0
Illinois	0	0	0	0	0	0	0	0	0	0
NY/NJ	0	0	2	4	21	55	0	0	0	0
Florida	4	11	4	14	24	48	0	0	0	0
California	2	4	14	32	8	38	0	0	0	0
Texas	4	8	1	2	5	10	0	0	0	0
	10	4%	21	8%	58	32%	0	0	0	0

As you can see, except for the four underlined locations, the evidence indicates this test was rarely performed.

SEC PROCEDURES LACK SUFFICIENT DETAIL

SEC examiners' procedures consist of a six-point checklist. Typically, the SEC examination checklists were filled in, but in most instances, we found little documentation to indicate the examinations' scopes. The Treasury Department official who is responsible for Bank Secrecy oversight believes SEC's checklist lacks sufficient detail and thus could result in inconsistent examinations. I should point out that many of the broker dealers SEC examines do not routinely handle cash, and for them, this portion of the examination is not applicable. However, we believe more detailed procedures are necessary for

those 700 or so institutions where cash transactions are probable.

IRS' RESPONSIBILITIES ARE NOT WELL DEFINED

IRS has detailed review procedures and documented support for its examinations. However, according to IRS officials they have difficulty identifying those financial institutions they should review for compliance with the act.

IRS cannot easily define the institutions under its jurisdiction because the implementing regulations do not clearly define those institutions. Treasury delegates responsibility for national banks to the Comptroller of the Currency, savings and loans to the Federal Home Loan Bank, etc., and then in essence delegates responsibility to IRS for any remaining miscellaneous financial institutions. However, the enabling regulations do not specifically identify these miscellaneous institutions. Further, once the types of institutions are defined, IRS has difficulty identifying the specific financial institution or business it should monitor in a given geographical area. IRS must continuously compile listings of the businesses subject to its examination by having IRS agents research the yellow pages of telephone directories.

EVIDENCE DOES NOT SUPPORT PERFORMANCE OF PROCEDURES

I made a point earlier of saying that, in many of the examinations reviewed, we could not determine to what extent

Bank Secrecy procedures were performed because examiners did not prepare appropriate supporting workpapers. Although there were check marks, tick marks, or short narrative statements in the examination reports signifying that the Bank Secrecy Act procedures were addressed, we found no complete workpapers to support the extent of work performed. For instance, of the 30 depository institution regulators' field offices we visited, only 4 had sufficiently documented the use of Module I Bank Secrecy Act procedures.

Without this documentation, any evaluation of the work done by examiners is hindered; thus a standard of performance and, ultimately, accountability, cannot be established. We have published a guide called, "Standards For Audit Of Governmental Organizations, Programs, Activities And Functions," which is used as a standard of performance for, among other things, reviews of compliance with laws and regulations. This guide states that workpapers should be complete and accurate, understandable, legible, and relevant to the objectives of the review.

EXAMINATION PROCEDURES COULD BE STRENGTHENED

The Council's model procedures used by the OCC, FRS, FDIC and the Bank Board could be improved in two areas. Under the current procedures, an examiner is required to determine if Currency Transaction Reports and Reports of International Transportation of Currency or Monetary Instruments are properly completed and filed with IRS or the U.S. Customs Service,

respectively, within 15 days of the transaction. The examiner is to accomplish this by reviewing the institution's copies of the completed forms. However, the examiner is not assured that these reports were, in fact, filed by the institution and received either by the IRS or Customs. As we recommended in our 1981 report, the procedures could be improved by providing examiners with a record of forms received by IRS and Customs so that they could verify that the reports found in the institutions were actually filed. Regulatory agency officials and examiners we spoke to in this review agreed that this information would help detect filing violations.

Secondly, the procedures should include a review of transactions which occur at facilities such as cash control centers and foreign exchange units. As a recently publicized Bank Secrecy-related case demonstrated, not all reportable transactions occur through a teller's window. In this case, many of the unreported transactions were related to cash transfers received from foreign banks. Yet, as noted by the Federal Reserve Bank of New York, the Council's procedures require examiners to test only teller transactions. In May 1985, the Federal Reserve Bank of New York informed its examiners that Bank Secrecy Act procedures should include an analysis of currency flows at all currency-handling facilities to ensure coverage of all reportable transactions. To better assure that the required currency transactions are being reported, we believe the Council's verification procedures

should require examiners to review all cash transactions at currency-handling facilities.

BANK SECRECY ACT COMPLIANCE MONITORING EFFORTS COULD BE IMPROVED

According to regulatory agency officials, Bank Secrecy Act monitoring could be improved if targeting information (such as intelligence and transaction data) and appropriate cash flow information were made available to them. Access to this type of data would enable regulators to direct their Bank Secrecy examinations at institutions with a high potential for violating the act. The Treasury Department, a focal point for intelligence data regarding financial institutions, should routinely share it with the regulatory agencies, to the extent permitted by law.

The FRS has current, nationwide data regarding depository institutions' cash transactions and flow. The FRS regards this information as being highly sensitive. However, it would be useful for targeting geographic areas and institutions where the potential for Bank Secrecy violations is high. Accordingly, while we don't propose routine release of such information to the regulators, we do believe that the FRS should provide this information on an exception basis--for example when it detects changes in cash flow patterns.

In 1981, we recommended that the regulators comprehensively examine, using the Council's procedures, a geographically dispersed, random sample of institutions scheduled for examinations. This approach is similar to IRS' tax audit

compliance approach, whereby the potential for being examined may be high enough to induce voluntary compliance by institutions. We still believe that, in addition to better targeting, use of a complete examination could enhance monitoring and enforcing compliance.

The regulatory officials had several objections to this approach back in 1981. For example, FDIC officials said that it would be inefficient, and that by using the Council's new procedures and currency flow data it could target resources. However, up to the period of our review, there was little evidence that the agencies had been performing the new procedures and routinely using currency flow data from the FRS to target institutions having unusual cash flow patterns.

In 1981, Bank Board officials said that this approach would be burdensome and that the Council's new procedures would improve its examinations. However, the Bank Board suspended mandatory use of those procedures in 1982.

TRAINING AND EXPERIENCE

Training

The majority of examiners we interviewed told us that they received their Bank Secrecy Act compliance training through self-study, informal lectures, and on-the-job training. Agency officials said that formal classroom training on this topic is very limited. Furthermore, the examiners told us that by virtue of their education and experience, they are adequately prepared to perform Bank Secrecy Act compliance examinations.

The seven agencies differ in the degree of formal Bank Secrecy Act training given to their examiners. For example:

--Neither the NCUA nor the SEC offers formal Bank Secrecy training.

--The Bank Board offers one classroom course which very briefly addresses (about 10 minutes) Bank Secrecy.

--The OCC offers two courses that briefly address Bank Secrecy issues.

--The FRS offers one course for new examiners which devotes 1 hour to Bank Secrecy and an advanced course which briefly describes this subject.

--The FDIC devotes 1 hour to Bank Secrecy in a course for more senior examiners.

--The IRS offers 2 hours of formal classroom training for excise tax examiners.

In order to supplement the formal training, OCC uses training teams that provide lectures covering Bank Secrecy issues. For its more experienced examiners, the FRS offers continuing education programs which address the Bank Secrecy Act. The other agencies provide Bank Secrecy Act seminars and on-the-job training.

We were unable to evaluate SEC's Bank Secrecy training. Two SEC officials told us that training for new examiners is provided by the NASD. To date, however, we have been unable to confirm this. NASD officials told us they rarely provide Bank Secrecy training to SEC's examiners, and when they do, it is

on an ad hoc basis. One NASD official estimated that in a typical year, two or three SEC examiners participate in NASD classes.

Experience

The experience of examiners performing Bank Secrecy examinations varies widely. Some agencies delegate this part of an examination to junior examiners, because it is generally considered one of the less difficult examination segments. Other agencies make no distinction based on experience and assign that segment to the examiner who can most easily complete the work. When possible, the FDIC typically has its more senior examiners complete the Bank Secrecy examinations. The FDIC's compliance examinations are normally performed by a special core of examiners who have successfully completed the agency's Consumer Protection School.

RECENT CHANGES

The Treasury Department and most regulatory agencies are considering improvements in their oversight of Bank Secrecy compliance. The proposals cover a variety of areas affecting the act's implementation. In addition to agency proposals, the Council is reevaluating its earlier interest in white collar crime training.

The Treasury Department is sponsoring a variety of efforts to improve the act's implementation. Treasury officials have organized an Interagency working group to modify existing Bank Secrecy Act examination procedures and develop new procedures where appropriate. The group includes representatives from the

seven agencies which are responsible for conducting these examinations. As a result of the group's first meeting in June 1985, representatives were instructed to review their examination procedures and submit written recommendations for improvements. When all responses are received, Treasury will reconvene the group to discuss their recommendations. Despite a July 1 deadline, only FDIC and NCUA had responded with recommendations as of October 1.

Mr. Chairman, this concludes my statement. I will be happy to discuss these recent changes in more detail and to respond to any questions from you or the other members of the Subcommittee.

Chairman ROTH. The subcommittee is in recess.

[Whereupon, at 10:49 a.m., the subcommittee was recessed to reconvene, subject to the call of the Chair.]

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